ATARI®
CORPORATION

Profile

Atari Corporation is one of the largest manufacturers of personal computers and video game systems in the world. Through creative application of advanced technologies, the Company offers its customers a wide range of computing power and entertainment. Among the Company's latest products are the palmtop Portfolio computer and hand-held Lynx color video game system. In addition to these revolutionary portables, Atari features a variety of powerful desktop systems including the enhanced version STE and TT030 computers, a range of PC-compatible computers, and the established 2600 and 7800 game systems. The Company also produces peripherals, accessories, and an expanding library of computer and video game software that is sold in almost every major country in the world. Atari is a multinational company employing approximately 1400 people throughout the world. Corporate headquarters, including computer and video game product design, are located in Sunnyvale, California. R&D centers are located in the United States, England, Japan, and Taiwan. Manufacturing is carried out in Taiwan, Japan, and at various subcontractors in the Far East. The Company operates through wholly owned subsidiaries in Australia, Austria, Belgium, Canada, Denmark, France, Germany, Hong Kong, Israel, Italy, Japan, Mexico, the Netherlands, Norway, Spain, Sweden, Switzerland, Taiwan, the United Kingdom, and the United States.

Front Cover Photograph: Atari portable Portfolio, shown in actual size.

To Our Shareholders

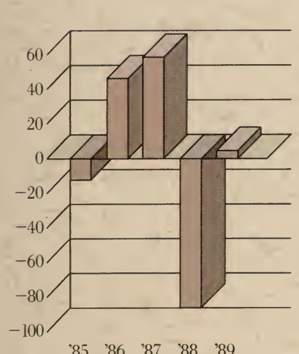
The year 1989 was a productive one for Atari Corporation. We set out in the beginning of the year with the objective of disposing of The Federated Group,™ and subsequent to year end, Atari consummated the sale of the majority of its Southern California leasehold interests. No additional losses are anticipated on final disposition of Federated and our focus is on our primary objective, Atari's core business.

For the year ended December 31, 1989, income from continuing operations was $4.0 million on sales of $423.6 million. This compares with income from continuing operations of $39.4 million on sales of $452.2 million for the year ended December 31, 1988. Net income was $4.0 million for the current year as compared to a loss of $84.8 million for the year ended December 31, 1988.

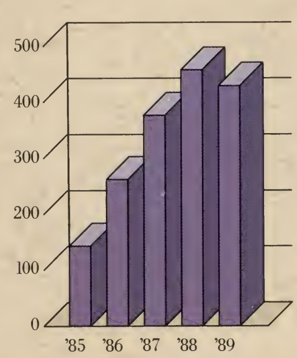
The decline in total sales for 1989 as compared to 1988 can be attributed to the decline in the United States of our traditional video game line. European markets continue to out-perform all other markets in both computers and video games.

In addition to witnessing the disposition of an extraneous business segment, Atari introduced a new generation of products: two revolutionary handheld machines—the Lynx™ Video Game system and the Portfolio™ computer—and the new STE,™ an enhanced member of the Atari ST™ family.

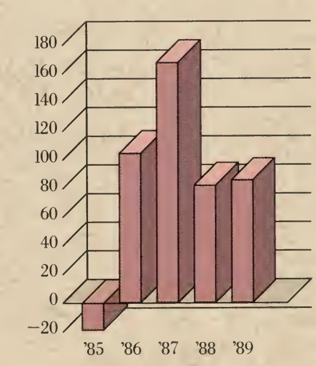
Net Income
(in millions)



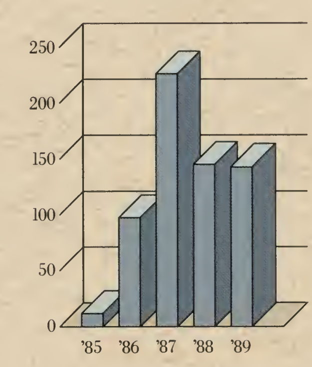
Net Sales
(in millions)



Shareholders' Equity
(in millions)

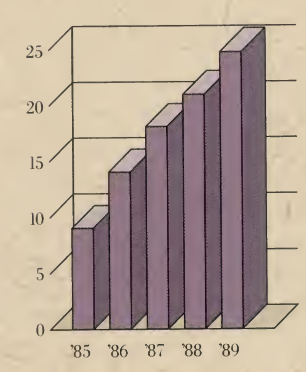


Working Capital
(in millions)



IMAGINATIVE DIRECTIONS In the fall of 1989, Atari launched the first full-featured MS-DOS® command compatible portable palmtop computer—the Atari Portfolio.™ The advent of Portfolio ushered in an entirely new dimension in computer practicality. It operates on 3 "AA" batteries with an approximate life of 4-6 weeks of regular use. The Portfolio provides its owner all of the power of a computer anywhere—on a plane, a classroom or in a hotel room. The system's credit-card-sized memory and program cards take the place of disks, allowing the user to store data and enter programs. A number of Portfolio programs soon to be released include: DOS Utilities, Finance, GW BASIC,® as well as a spell checker, a math/engineering program, a modem package, and a chess game, with many others to come. The growing popularity of this new product and the concept of portable computer technology is an area we intend to pursue. Projects are underway to develop even more elaborate portable systems. **VIDEO GAMES** The new, portable, Atari Lynx™ system represents a major leap in video-game technology. It has a unique full-color, high-resolution graphics LCD which allows for the best arcade hits to be produced for the Lynx. Lynx was recognized as a revolutionary achievement by the trade when it was first introduced at the Consumer Electronics Show in Chicago last summer. Shipments began just prior to Christmas in New York City and Tokyo and these two test markets were sold out. The Lynx features a full color liquid crystal display driven by a 16-bit graphics engine. A palette of 4096 colors permits as many as 16 colors to appear on screen at once, creating extraordinary graphics. The system also has a 32-bit

R&D Expenditure
(in millions)



Along with the Portfolio's 128K of built-in Random Access Memory is a set of important built-in applications including: a Lotus 1-2-3® WKS file compatible worksheet, a word processor, an address book, a telephone tone dialer, and a diary/calendar.

Available peripherals allowing you to connect to the Portfolio's main ports transfer data to and from IBM,® Atari ST™ and Apple® Macintosh® computers. You can also connect the Portfolio to industry standard compatible printers and modems.

With its state-of-the-art Super Twist liquid crystal display and its 63-key QWERTY keyboard, the Portfolio is easy to read and even easier to use. It weighs less than a pound and is just 7⅞" L x 4⅛" H x 1⅛" D.

A:MOSALES.WKS
B2:(C2) [W11] 3789
A
B
C
Jan
Feb
1 Mo.Sales
2 M320 $3,789.00 $6,651.00
3 M321 $5,639.00 $7,636.00
4 M322 $8,621.00 $8,851.00
Thu 17 Jun 99 14:50
INS
Portfolio
ATARI
ATARI Portfolio
MEMORY CARD
128 Kilobytes
ATARI CORPORATION
Insert card this side up.

audio processor with 4-channel sound to enhance game action. "AA" batteries enable the game player to enjoy arcade excitement on the beach, in the schoolyard and in the car. The unit comes with a headset jack, an AC adaptor, and a Comlynx™ cable so that, depending upon the game, as many as 16 players can compete with one another. Software support for the new Lynx has been equally impressive. In less than four months, six top game titles were released. The most recent, Gauntlet—The Third Encounter,® is a 1, 2, 3 or 4 player game. The future for the Lynx product category is extremely bright. We recognize that the success of this important product depends chiefly on software. I am pleased to say that our video game software group is currently producing exciting titles, which include some arcade hits. As many as 25 new games are planned for release by Christmas, and new hardware peripherals are presently under development.

BUILDING FOR THE YEAR AHEAD In addition to our portable Lynx and Portfolio Systems, new product development for our flagship ST line is continuing. Volume shipments of the ST^E, an enhanced general application system, began during the fourth quarter. In 1989 we also introduced the versatile TT030,™ a 68030-based computer which will run the TOS operating system in native mode, as well as having the option to run UNIX® V.3.1. Shipments of the TT030 will start during the second half of 1990, while shipments of the Stacy, an ST compatible laptop, began at the end of the first quarter of 1990. As we enter a new year, our biggest opportunity still awaits us. Earlier plans to enter the U.S. market were impeded by lack of product availability

The portable full color Atari Lynx runs on "AA" batteries or AC current.

Available Arcade hits:
California Games®
Blue Lightning™
Electrocop™
Gates of Zendocon™
Chip's Challenge™
Gauntlet–The Third Encounter®

Coming in 1990:
Flying Ace™
720
Paperboy™
A.P.B
Rygar™
Football
3D Barrage™
Road Blasters™
Super Soccer™
Checkered Flag™
Tournament Cyberball™
Zarlor Mercenary™
Xenophobe™
Klax™
Rampage®
Vindicators™
Ninja Gaiden™
Slime World™
Turbo-Sub™
Junkyard Dog™
and many more


ATARI
LYNX

caused by the DRAM situation. With this and other interferences behind us, we are eagerly preparing for the American market. A multi-million dollar advertising plan for both Atari video games and computer systems is now being reviewed and our sales force is being prepared to cover this vast and lucrative arena. We also view the recent changes in Eastern Europe with great optimism. We plan to use our strong European presence to enhance our position in this new marketplace. **W**ith increased business comes the need for larger facilities. Our German subsidiary is now in the process of building its own 110 thousand square foot office-warehouse facility in Schwalbach, a suburb of Frankfurt. I want to extend my thanks to our colleagues at Atari France, who last fall suffered a devastating fire which began in an adjacent building and spread to the Atari facility. Despite the total destruction of their building, our French team salvaged what records they could, and continued business in a speedy and efficient manner. They have relocated to a new Atari-owned, thirty-three thousand square foot office-warehouse complex. **I** also wish to extend my appreciation to our many customers, shareholders, suppliers, employees and enthusiastic user groups everywhere, for their support and encouragement. **I** am confident that in the year ahead we will continue to gain market share in our important sectors, as well as innovate and bring exciting products to our customers.

Sam Tramiel, President

The TT030 is the most ambitious ST computer to date. It is an ST-compatible computer that can also serve as a UNIX workstation. The TT030 features an enhanced 4096-color palette which allows up to 256 colors on a single screen, six video modes, and stereo sound, making it the perfect choice for professional animation, design, and engineering applications.

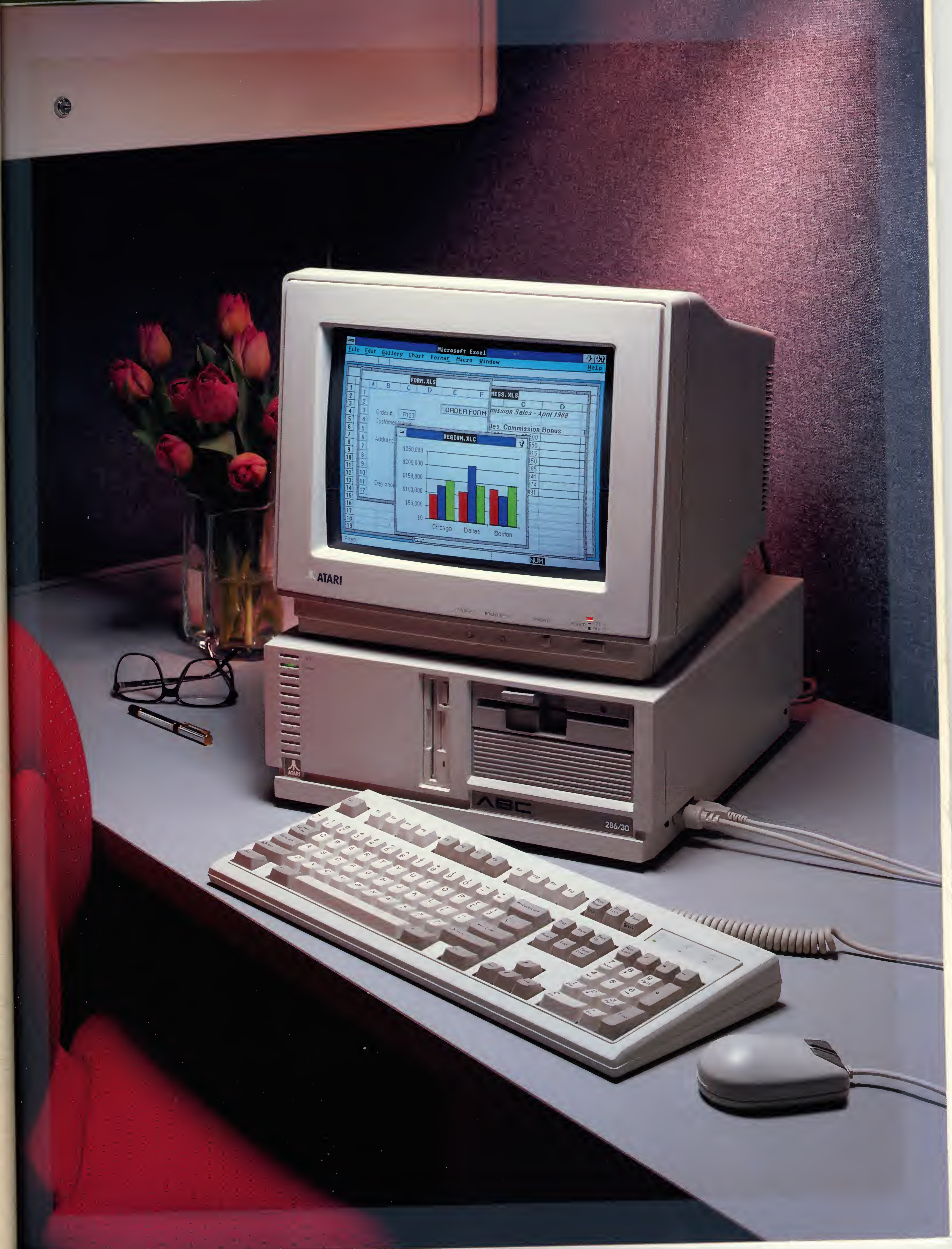
UNIX compatibility and LAN ports allow for multitasking and multiple-user networking, as well as state-of-the-art programming tools.


Desk File Page Zoom Edit Arrange Text Line Pattern Color
Settings...
ATARI TTC1434
TT030/2

THE ATARI PC LINE Early in the year Atari began to ship the first significant volumes of the 80286-based PC compatible, the PC4.™ Atari is now shipping a range of PC compatibles, and during the second quarter of 1990, the company will add the ABC386SX™ to this family. The ABC386SX is Atari's entry into the field of affordable 32-bit compatible PCs. Built around the 386SX™ high-performance microprocessor, the ABC386SX has a clock rate of 16 MHz. Its five display modes include EGA, CGA, MDA, HGC,™ and VGA, providing a range of resolutions from 320 x 200 color to 720 x 350 monochrome. With one full megabyte of RAM, expandable to 8 Mbytes on the mother board, the ABC386SX has all the memory needed to run today's sophisticated software applications. The ABC386SX comes standard with 3½-inch 1.44 Mbyte floppy disk drive and/or a 5¼-inch 1.2 Mbyte floppy disk drive and a hard disk drive. The system also has serial and parallel ports, an analog video port, and 3 AT®/XT™ expansion slots. The unit has a 101 key AT-style keyboard.

MORE ST POWER The basic ST system has been enhanced. In addition to all of the proven features of the original model, the new STᴱ has an increased palette of 4096 colors. Its sound has also been expanded by the addition of two digital stereo audio outputs. The two stereo outputs allow users to play digitized samples directly from their computer without any costly synthesizer equipment. The STᴱ has been made into a very powerful game system as well. It can accommodate up to 6 joysticks, or 4 paddles, or a light gun. Horizontal and vertical scrolling combined with its new enhanced digitized sound, and extensive color palette, provides realistic arcade excitement. As a broad application, affordable business tool, the STᴱ has made a very successful entry into Atari's established European markets and is planned for the U.S. market in the second quarter.

The ABC386SX is a 16 MHz, AT-compatible PC with 2 to 8 Mbytes of RAM. The computer's video subsystem offers high resolution VGA graphics in brilliant colors. The ABC386SX comes with one 3½-inch floppy disk drive and an internal hard disk drive. Serial, parallel, and video ports, along with AT/XT expansion slots, make the powerful ABC386SX a versatile business tool for every office.


Microsoft Excel
File Edit Gallery Chart Format Macro Window
Help
FORM.XLS
ORDER FORM
Commission Sales - April 1988
Commission Bonus
REGION.XLC
$250,000
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$100,000
$50,000
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Chicago
Dallas
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ATARI
ABC
286/30

TT030—THE POWER TRAIN The 68030-based TT030 is the top-of-the-line system as Atari begins the 90s. Previewed during the last quarter of 1989, this 16 MHz powerplant is designed to be a fully functional workstation at PC prices. Incorporating Atari's own expanded Rainbow TOS™ operating system, the TT will also run the industry-standard UNIX* V.3.1 operating system with X-Windows™ and an easy-to-use user interface. The new unit provides six video display modes including 1280 x 960 high resolution monochrome. Since the system also features enhanced color graphics and has a palette of 4096 colors, its 320 x 480 mode is able to create superb TV-like images with up to 256 colors on the screen at one time. Among the many built-in highlights of the TT030 is an industry-standard VMEbus. This allows the TT030 to accommodate such local area network standards as Ethernet.™ A complete range of peripherals will be available to support the system.

STACY—THE PORTABLE ST For people on the go, the Atari Stacy puts all the power of Atari's popular ST into a self-contained, portable package. Available in a variety of MEGA™ configurations, the Stacy includes built-in floppy and hard drives, plus all of the standard modem, printer and MIDI ports found on the ST. Beneath its top cover is a large backlit 640 x 400 high-resolution supertwist liquid crystal display. In addition to its full-size keyboard, the Stacy has an integrated Trak-Ball™ controller. The unit features Atari's latest Rainbow TOS operating system and is driven by the Motorola™ 68000 microprocessor.

The ST^E is an ST-compatible all-purpose system with exciting new features. With from one-half to four Mbytes of RAM, the computer offers an extended 4096-color palette and stereo sound. The visual and audio capabilities of the ST^E will provide a platform for enhanced software for use by students, educators, business professionals, designers, and musicians while also running software designed for the ST computer.


Desk File Layout Edit Sequence Draw Print Page 01 Bar 001
SuperScore
Titles... [ESC T]
Hdrs & Ftrs...
Page Size...
Output Score... [ESC O]
Print Parts... [ESC Z]
Print Curr Page [CTL O]
Ext Prt Drvr.. [ESC I]
✓ Final/Multi Strike
✓ Offset (3 Pass)
Piano
Cm7
Cmin7
Cmin7 9
ATARI
ATARI
1040ST
Backspace
Help
Undo

MUSIC AND MOTION PICTURES

The unique combination of Atari's precision operating system, its built-in MIDI ports, ease-of-use, and affordability, has made the Atari computer an essential instrument in the music and movie industry. For Dave Grusin, 1989 Oscar winner for his musical score in the *Milagro Beanfield War*, the Atari ST is a major asset in his work. Having also earned three Grammys including one for the *Fabulous Baker Boys*, Grusin admits that, "the ST was indispensible in editing the vocals for both the motion picture and the soundtrack." Scott Gershon, sound effects editor for Oliver Stone's *Born on the Fourth of July*, agrees. His Atari ST was used to edit the audio for this major motion picture. Other recent pictures on Atari's marquee are TriStar Pictures' *Glory* and *Steel Magnolias*, and *Honey I Shrunk the Kids* from Walt Disney Studios. A partial list of popular bands and artists who rely upon their Atari ST systems today and are rapidly discovering the added convenience of the new portable Stacy include: Beach Boys, Blue Oyster Cult, Dire Straits, Earth, Wind and Fire, Fleetwood Mac, Peter Gabriel, Debbie Gibson, The Go Gos, Dave Grusin, Hall and Oates, Ice House, Madonna, Dave Mason, Midnight Oil, Miami Sound Machine, The Moody Blues, New Kids on the Block, Donny Osmond, The Pointer Sisters, Lee Ritenour, Supertramp, Tangerine Dream, 38 Special, Ultravox, Van Halen, Whitesnake, Steve Winwood, and Joseph Zawinual.

The new Atari Hotz MIDI Translator™ and Stacy portable computer are important components of the 1990 Fleetwood Mac World Tour. World renown musician Mick Fleetwood and music producer-inventor Jimmy Hotz are pictured here with the Atari Hotz MIDI Translator. The Atari Hotz MIDI Translator combines a powerful Atari computer with a controller designed to give maximum musical expression, flexibility, and sensitivity.

The Atari Stacy computer offers the busy musician total ST compatibility along with the convenience of a completely portable system. The Stacy features a built-in hard disk drive, an easy-to-use Trak-Ball controller, and a back lit, super twist 6" x 9" high resolution Liquid Crystal Display.

As of December 31, *(dollars in thousands)*	*1989*	*1988*
Assets		
CURRENT ASSETS:		
Cash and equivalents, including $3,884 held as compensating balances in 1989 (Note 6)	$ 54,912	$ 91,890
Trade receivables (less allowance: 1989, $2,903; 1988, $3,236)	106,972	100,564
Inventories (Notes 2 and 4)	129,881	117,903
Prepaid expenses and supplies	4,726	3,403
Other current tax assets	10,322	10,322
Total current assets	306,813	324,082
PROPERTY—Net (Note 5)	13,900	8,463
OTHER ASSETS	9,939	5,813
TOTAL	$ 330,652	$ 338,358
Liabilities and Shareholders' Equity		
CURRENT LIABILITIES:		
Notes payable (Note 6)	$ 35,433	$ 18,509
Accounts payable	84,072	52,651
Net current liabilities of discontinued operations (Note 3)	11,868	47,401
Income taxes payable	367	11,435
Accrued liabilities (Note 8)	35,511	50,131
Total current liabilities	167,251	180,127
LONG-TERM OBLIGATIONS (Note 6)	77,402	75,000
COMMITMENTS (Note 7) AND CONTINGENT LIABILITIES (Note 13)		
SHAREHOLDERS' EQUITY (Note 10):		
Preferred stock, $.01 par value—authorized 10,000,000 shares; none outstanding	—	—
Common stock, $.01 par value—authorized, 100,000,000 shares; outstanding: 1989, 57,697,835 shares; 1988, 57,739,289 shares	577	577
Additional paid-in capital	143,226	142,658
Notes receivable from sale of common stock	(827)	(1,141)
Accumulated deficit	(55,928)	(59,945)
Accumulated translation adjustments	(1,049)	1,082
Total shareholders' equity	85,999	83,231
TOTAL	$ 330,652	$ 338,358

See notes to consolidated financial statements.

Consolidated Statements of Operations

Year Ended December 31, *(in thousands, except per share data)*	*1989*	*1988*	*1987*
NET SALES:			
New and redesigned products	$ 423,606	$ 452,201	$ 358,003
Purchased products (Note 2)	—	—	4,605
Total	423,606	452,201	362,608
COSTS AND EXPENSES:			
Cost of sales:			
New and redesigned products	309,419	280,448	201,270
Purchased products	—	—	3,763
Research and development	24,613	21,364	18,046
Marketing and distribution	66,423	71,874	53,810
General and administrative	19,473	18,923	13,703
Total	419,928	392,609	290,592
OPERATING INCOME	3,678	59,592	72,016
Other income (expense)—net	971	(1,657)	7,262
Interest income	4,107	5,351	7,121
Interest expense	(6,287)	(4,783)	(3,167)
Income before income taxes	2,469	58,503	83,232
Provision (credit) for income taxes (Note 9)	(1,548)	19,100	33,823
INCOME FROM CONTINUING OPERATIONS BEFORE EXTRAORDINARY CREDIT	4,017	39,403	49,409
Discontinued operations (Note 3):			
Loss from operations of The Federated Group	—	(67,166)	(5,257)
Provision for loss on disposition of The Federated Group	—	(57,055)	—
Income (loss) before extraordinary credit	4,017	(84,818)	44,152
Extraordinary credit—tax reduction from use of net operating loss carryforwards	—	—	13,277
NET INCOME (LOSS)	$ 4,017	$ (84,818)	$ 57,429
EARNINGS (LOSS) PER COMMON AND COMMON EQUIVALENT SHARE:			
Primary:			
Income from continuing operations	$ .07	$ .68	$ .85
Income (loss) before extraordinary credit	$ .07	$ (1.46)	$ .76
Net income (loss)	$ .07	$ (1.46)	$ .99
Fully diluted:			
Income from continuing operations	$ .07	$ .67	$ .83
Income (loss) before extraordinary credit	$ .07	$ (1.31)	$ .74
Net income (loss)	$ .07	$ (1.31)	$ .96
Number of shares used in computations:			
Primary	58,079	57,964	58,052
Fully diluted	58,142	62,562	61,500

See notes to consolidated financial statements.

For the Years Ended December 31, 1987, 1988 and 1989 (in thousands)	*Common Stock*		*Additional Paid-In Capital*	*Notes Receivable From Sale of Common Stock*	*Accumulated Deficit*	*Accumulated Translation Adjustments*	*Total*
	Shares	*Amount*					
BALANCES, JANUARY 1, 1987	57,788	$ 578	$ 142,476	$ (2,299)	$ (32,556)	$ (2,777)	$ 105,422
Stock options exercised	26	1	126	—	—	—	127
Common stock repurchased	(111)	(2)	(355)	123	—	—	(234)
Payments on notes receivable	—	—	—	759	—	—	759
Translation adjustments	—	—	—	—	—	4,152	4,152
Net income	—	—	—	—	57,429	—	57,429
BALANCES, DECEMBER 31, 1987	57,703	577	142,247	(1,417)	24,873	1,375	167,655
Stock options exercised	60	1	440	—	—	—	441
Common stock repurchased	(24)	(1)	(29)	—	—	—	(30)
Payments on notes receivable	—	—	—	276	—	—	276
Translation adjustments	—	—	—	—	—	(293)	(293)
Net loss	—	—	—	—	(84,818)	—	(84,818)
BALANCES, DECEMBER 31, 1988	57,739	577	142,658	(1,141)	(59,945)	1,082	83,231
Stock options exercised	110	1	734	—	—	—	735
Common stock repurchased	(151)	(1)	(166)	—	—	—	(167)
Payments on notes receivable	—	—	—	314	—	—	314
Translation adjustments	—	—	—	—	—	(2,131)	(2,131)
Net income	—	—	—	—	4,017	—	4,017
BALANCES, DECEMBER 31, 1989	57,698	$ 577	$ 143,226	$ (827)	$ (55,928)	$ (1,049)	$ 85,999

See notes to consolidated financial statements.

Consolidated Statements of Cash Flows

Year Ended December 31, (in thousands)	*1989*	*1988*	*1987*
Cash Flows From Operating Activities:			
Net cash provided (used) by continuing operations	$ (5,897)	$ 2,169	$ 23,283
Net cash provided (used) by discontinued operations	(35,533)	(19,810)	1,811
Net cash provided (used) by operating activities	(41,430)	(17,641)	25,094
Cash Flows From Investing Activities:			
Purchase of The Federated Group	—	—	(64,078)
Net short-term investments and restricted cash	—	18,008	(16,333)
Other assets	(4,108)	4,808	(7,522)
Property purchases	(5,552)	(2,481)	(3,135)
Sale of property	305	224	117
Net cash provided (used) by investing activities	(9,355)	20,559	(90,951)
Cash Flows From Financing Activities:			
Additions to borrowings	—	—	75,000
Repayment of borrowings	—	—	(2,243)
Net short-term borrowings	15,871	9,330	9,153
Issuance of common stock, net	882	687	652
Net cash provided by financing activities	16,753	10,017	82,562
Effect of Exchange Rate Changes On Cash and Equivalents	(2,946)	2,869	(11,398)
Net Increase (Decrease) In Cash and Equivalents	(36,978)	15,804	5,307
Cash and Equivalents:			
Beginning of year	91,890	76,086	70,779
End of year	$ 54,912	$ 91,890	$ 76,086
Other Cash Flow Information (From Continuing Operations):			
Interest paid	$ 6,167	$ 4,732	$ 480
Income taxes paid	9,520	14,534	527
Reconciliation of Net Income (Loss) to Net Cash Provided (Used) by Continuing Operations:			
Net income (loss)	$ 4,017	$ (84,818)	$ 57,429
Loss from discontinued operations	—	124,221	5,257
Depreciation and amortization	2,483	2,076	1,817
Provision for doubtful accounts	1,083	1,060	2,068
Provision for sales returns and allowances	4,797	14,626	3,721
Changes in operating assets and liabilities:			
Trade receivables	(8,393)	(14,033)	(49,446)
Inventories	(10,429)	2,022	(40,050)
Prepaid expenses	(1,185)	(1,280)	(1,221)
Other current tax assets	—	(10,322)	—
Accounts payable	31,351	(14,851)	23,609
Income taxes payable	(10,028)	(7,119)	16,160
Accrued liabilities	(19,593)	(9,413)	3,939
Net cash provided (used) by continuing operations	$ (5,897)	$ 2,169	$ 23,283
Noncash Investing and Financing Activities:			
Issuance of debt in exchange for land and buildings	$ 2,402	—	—

See notes to consolidated financial statements.

Note 1. Organization and Significant Accounting Policies

Organization The Company was formed in May 1984 to design, manufacture, sell and service personal computers, video games and related software and peripheral products. The principal methods of distribution are through computer specialty dealers and mass market retailers. Effective December 1988 the Company decided to discontinue its future operation of The Federated Group, Inc. ("Federated"), a retailer of consumer electronics and home entertainment products acquired in 1987 (see Note 3).

Principles of consolidation The consolidated financial statements include the Company and its subsidiaries. All transactions and balances between the companies are eliminated.

Cash and equivalents Cash equivalents are stated at cost, which approximates market; have maturities not exceeding ninety days upon acquisition; and generally consist of certificates of deposit, time deposits, treasury notes and commercial paper.

Inventories are stated at the lower of cost or market. Cost is computed using standard costs which approximate cost on a first-in, first-out basis.

Property is stated at cost (see Note 5). Depreciation is computed using the straight-line method based on estimated useful lives of the assets of 2 to 30 years. Leasehold improvements are amortized over the estimated useful life or lease term, as appropriate.

Revenue recognition Sales are recognized upon shipment.

Research and development expenditures are expensed as incurred.

Income taxes Effective January 1, 1988, the Company adopted Statement of Financial Accounting Standards No. 96 (SFAS 96) "Accounting for Income Taxes." The effects of adopting SFAS 96 were not material in 1988. SFAS 96 changed the criteria for measuring income taxes and recognizing deferred tax assets and liabilities on the balance sheet. The statement restricts recognition of deferred tax assets and further requires that all deferred tax balances be determined using tax rates expected to be in effect when the taxes are paid, based on enacted tax laws. Further, tax benefits attributable to operating loss carryforwards are reported as direct reductions of the income tax provision whereas such benefits were reported as extraordinary credits in prior years. Tax credits reduce the provision for income taxes when realizable.

Foreign currency translation Assets and liabilities of operations outside the United States, except for operations that are highly integrated with operations of the Company (principally in Taiwan), are translated into United States dollars using current exchange rates, and the effects of foreign currency translation adjustments are deferred and included as a component of shareholders' equity. For operations that are highly integrated, foreign currency translation adjustments are included in operations. Exchange and translation gains (losses) included in operations for the years 1989, 1988 and 1987 were \$(2,278,000), \$(4,779,000) and \$3,828,000, respectively.

Earnings (loss) per common and common equivalent share Per share amounts are computed based on the weighted average number of common and common equivalent shares (stock options) outstanding during each period.

Fully diluted earnings per share assumes the dilutive effect of both the conversion of the 5¼% convertible debentures for the period they were outstanding (see Note 6) and the additional dilutive effect of stock options. Interest expense of \$3,938,000 (\$2,652,000 net of income taxes) and interest expense of \$2,625,000 (\$1,548,000 net of income taxes) related to the 5¼% convertible debentures has been added to net income, income before extraordinary credit and income from continuing operations, respectively, in calculating fully diluted earnings per share for 1988 and 1987, respectively. The conversion of the 5¼% convertible debentures is antidilutive in 1989 and is excluded from the fully diluted earnings per share computation.

Fiscal Year During 1987, the Company adopted a 52/53 week fiscal year which ends on the last Saturday closest to December 31. Fiscal years 1987, 1988 and 1989, all have 52 weeks. For simplicity of presentation, the date December 31 is used to represent the fiscal year end.

Note 2. Acquisition And WCI Transactions

Effective July 2, 1984, the Company acquired certain assets and assumed certain liabilities of certain associated entities of Warner Communications Inc.'s (collectively referred to as "WCI") Atari home computer and home video game product lines. In connection with this acquisition, the Company obtained certain products which were not consistent with its long-range business strategy. Accordingly, the Company instituted a plan to liquidate the inventory and a portion of the manufacturing and distribution facilities acquired; the related product sales and costs are classified as purchased products in the consolidated statements of operations.

Note 3. The Federated Group, Inc.

On October 4, 1987, the Company acquired all the outstanding capital stock of The Federated Group, Inc. (Federated), a retailer of consumer electronic and home entertainment products with stores in Arizona, California, Kansas, New Mexico and Texas for $64.1 million in cash. This transaction was accounted for as a purchase and included $13.5 million in goodwill.

In March 1989, as a result of Federated's losses and cash flow requirements, the Board of Directors approved the Company's decision to discontinue its operation of Federated and accordingly, the assets and liabilities and operating results of Federated are shown as discontinued operations in these consolidated financial statements. The Company reflected this decision in 1988 by writing off its remaining investment in Federated and providing for anticipated financial obligations and losses arising from this investment, totalling $64.8 million (before allocation of income tax benefits of $7.8 million). As a result of a change in strategy, Federated's operating losses during the phase-out period have exceeded the $12 million reserve for such losses included in the $64.8 million provision in 1988. These higher losses were offset by the settlement of certain obligations at lower than estimated amounts. During the phase-out period, the Company has terminated and sold certain leasehold interests of Federated and continues to seek buyers for the remaining assets. The Company intends to complete its disposition of Federated by the end of 1990 and believes that additional losses beyond those provided would not be material. Net sales of Federated for 1989, 1988 and 1987 since acquisition were $111.4 million, $253.0 million and $130.6 million respectively. Net losses of Federated for those periods were $37.4 million, $67.2 million and $5.3 million (net of income tax benefits in 1988 and 1987 of $9.5 million and $3.0 million), respectively.

Net current and noncurrent assets and liabilities of discontinued operations are shown as single items in the consolidated balance sheets and consist of the following (in thousands):

	December 31, 1989	*December 31, 1988*
Current assets	$ 10,481	$ 43,954
Non-current assets	38,793	60,138
Total assets	49,274	104,092
Current liabilities	20,839	62,930
Non-current liabilities	12,912	23,757
Total liabilities	33,751	86,687
Net assets before discontinuation accruals	15,523	17,405
Accrued discontinuation costs and losses	(27,391)	(64,806)
Net liabilities of discontinued operations	$ (11,868)	$ (47,401)

At December 31, 1989 and 1988, Federated's accounts payable included approximately $3.6 million and $12.8 million respectively, due to companies ("flooring companies") to whom vendors assign accounts arising from Federated's purchase of inventory. The flooring companies have a purchase money security interest in any unsold inventory arising from such purchases.

At the time of acquisition by the Company, Federated's non-current liabilities included 7½% convertible subordinated debentures (face amount $40.0 million), due April 15, 2010. The $17.5 million discount recorded at the acquisition date is being amortized over the remaining term of the debentures, resulting in an effective 13.9% interest rate. During 1989 the Company acquired $19.5 million face value of the debentures and the resulting gain is included in discontinued operations. The remaining debentures are convertible into $6.25 in cash for each of the 878,869 shares of Federated's common stock into which the remaining debentures may be converted.

Note 4. Inventories

Inventories at December 31 consist of the following (in thousands):

	1989	*1988*
Finished goods	$ 78,110	$ 80,307
Raw materials and work-in-process	51,771	37,596
Total	$ 129,881	$ 117,903

Note 5. Property

Property at December 31 consists of (in thousands):

	1989	1988
Land	$ 4,803	$ 2,487
Buildings	3,626	2,231
Machinery and equipment	10,196	6,787
Furniture and fixtures	2,142	1,729
Leasehold improvements	839	834
Total	21,606	14,068
Accumulated depreciation and amortization	(7,706)	(5,605)
Property—net	$ 13,900	$ 8,463

Note 6. Debt Obligations

At December 31, 1989, short-term notes payable of $8.9 million at 7.563% were outstanding under a $15.0 million borrowing facility. These borrowings are 20% collateralized by cash. In addition the Company was obligated for $26.5 million of overdrafts and short-term borrowings payable to banks under borrowing facilities of its subsidiaries at rates ranging from 8.2% to 10.3%. Certain of the borrowings are collateralized by manufacturing facilities in the Far East.

In April 1987, the Company sold $75.0 million principal amount of 5¼% convertible subordinated debentures due April 29, 2002. The debentures may be redeemed subsequent to April 29, 1990, at the Company's option, upon payment of a premium. Holders may convert their debentures into common stock at $16.31 per share. At December 31, 1989, 4,597,700 shares of common stock are reserved for the conversion of the debentures. Default with respect to other indebtedness of the Company in an aggregate amount exceeding $5.0 million would result in an event of default whereby the outstanding debentures would be due and payable immediately.

In addition, at December 31, 1989, the Company has a term loan outstanding of $2.4 million for the purchase of land and buildings in France. The loan is due in fifteen equal annual installments through 2004. Approximately half of the amount bears interest at a fixed rate of 9.6%, the remainder bears interest at the French prime rate plus 1.2%. The loan is secured by the related land and buildings.

At December 31, 1989, an aggregate of $16.2 million in multicurrency bank credit arrangements was available to the Company and its subsidiaries with various interest rates and security arrangements.

Note 7. Commitments

The Company leases various facilities and equipment under noncancellable operating lease arrangements. The major facilities leases are for terms of one to 19 years and are accounted for as operating leases. These leases generally provide renewal options of five additional years. Minimum future lease payments under all noncancellable operating leases as of December 31, 1989 are as follows (in thousands):

1990	$ 3,131
1991	2,132
1992	1,384
1993	835
1994	743
Later years	4,453
Total minimum lease payments	$ 12,678

Rent expense for all operating leases was $3,149,000, $2,879,000, and $3,384,000 for the years 1989, 1988 and 1987, respectively.

Note 8. Accrued Liabilities

Accrued liabilities at December 31 consist of the following (in thousands):

	1989	1988
Accrued royalties	$ 5,932	$ 7,985
Accrued customer allowances	7,676	19,713
Other	21,903	22,433
Total	$ 35,511	$ 50,131

Note 9. Income Taxes

The provision for income taxes consists of (in thousands):

	1989	1988	1987
Current:			
Federal	$ —	$ 12,556	$ 15,706
Foreign—net of $2,823 and $3,189 benefit from loss carryforwards in 1989 and 1988, respectively	(1,548)	6,736	3,827
State	—	622	—
Total current	(1,548)	19,914	19,533
Deferred:			
Federal	—	(814)	864
State	—	—	149
Total deferred	—	(814)	1,013
Charge equal to benefit from net operating loss carryforwards:			
Federal	—	—	11,956
Foreign	—	—	1,321
Total charge	—	—	13,277
Provision (credit) for income taxes	$ (1,548)	$ 19,100	$ 33,823

In 1989 and 1988 the tax benefit from operating loss carryforwards was reported as a direct reduction of income taxes as required by SFAS 96 whereas such benefits were reported as an extraordinary credit in 1987. Deferred taxes are attributable to accrued liabilities and allowances. Income (loss) before income taxes for the years 1989, 1988 and 1987 includes income of $313,000, $22,382,000 and $8,646,000, respectively, from the Company's foreign subsidiaries. The temporary difference relating to the earnings of foreign subsidiaries for which a deferred tax liability has not been recognized, assuming repatriation, approximates $35 million at December 31, 1989. The additional taxes which may become due if those earnings were to be remitted to the U.S. are not material. However, it is management's intent that these earnings remain invested indefinitely.

At December 31, 1989, the Company has a book operating loss carryforward of approximately $63 million ($28 million for tax reporting purposes). The book and tax loss carryforwards will expire in 2004.

As of December 31, 1989, the Company has approximately $6 million of operating loss carryforwards for state tax reporting purposes available to reduce state income taxes through 2004.

The effective income tax rates for 1989, 1988 and 1987 were (63)%, 33% and 41%, respectively, and differ from the federal statutory rate of 34%, 34% and 40% as follows (in thousands):

	1989	1988	1987
Computed at statutory rates	$ 840	$ 19,891	$ 33,293
Effect of foreign tax assessment on purchase price allocations	—	1,231	—
Effect of foreign losses providing no tax benefit	1,963	20	955
Tax benefit of foreign loss carryforwards	(2,823)	(3,189)	—
Effect of foreign tax rates different than statutory rates and foreign loss carrybacks	(795)	1,133	—
Effect of foreign and research tax credits	—	(1,469)	—
State income taxes, net of federal income tax benefit	—	411	—
Benefit from losses of discontinued operations	(733)	—	—
Other	—	1,072	(425)
Provision (credit) for income taxes	$ (1,548)	$ 19,100	$ 33,823

In the fourth quarter of 1989, the Company decreased its effective annual tax rate from a credit of 34% to a credit of 63% due primarily to the utilization of foreign loss carryforwards. This resulted in an effective tax rate credit of 12% for the fourth quarter of 1989.

Note 10. Shareholders' Equity

All share and per share amounts give effect to a 2-for-1 stock split in June 1987.

Common Stock Founders and employees of the Company have purchased 33,422,466 common shares under stock purchase agreements at fair market value as determined by the Board of Directors. The employees' shares generally vest 20% at the end of each of the initial five years of employment. At December 31, 1989, 265,100 unvested shares were subject to repurchase.

In 1986, the Company adopted a stock option plan and a restricted stock plan. The plans provide for the issuance of up to 3,000,000 shares of common stock through the issuance of incentive stock options to employees, and non-qualified stock options and restricted stock to employees, directors and consultants. Under the plans, stock options or restricted stock may be granted at not less than fair market value as determined by the Board of Directors. Stock options become exercisable as established by the Board (generally ratably over 5 years) and expire up to 10 years from date of grant. The Company's right to repurchase restricted stock lapses over a maximum period of five years. At December 31, 1989, options for approximately 582,591 shares were exercisable and options for 916,430 shares were available for future grant. At December 31, 1989, no restricted stock under the restricted stock plan had been issued.

At December 31, 1989 the Company had reserved 7,401,331 shares of common stock for issuance under stock plans and for conversion of the 5¼% debentures.

Additional information with respect to the stock option plan is as follows:

	Number of Shares	Option Price Range Per Share		Total
		Low	High	
Outstanding, January 1, 1987	193,000	$ 1.00 -	$ 6.50	$ 783,250
Granted	1,674,978	5.75 -	13.87	12,625,451
Exercised	(26,052)	5.75 -	6.94	(127,034)
Cancelled	(336,362)	2.50 -	13.25	(3,267,542)
Outstanding, December 31, 1987	1,505,564	1.00 -	13.87	10,014,125
Granted	897,000	5.75 -	8.63	6,256,500
Exercised	(60,771)	1.00 -	6.94	(440,401)
Cancelled	(468,344)	3.00 -	13.87	(3,432,556)
Outstanding, December 31, 1988	1,873,449	1.00 -	13.06	12,397,668
Granted	682,900	5.13 -	14.00	4,582,600
Exercised	(109,546)	1.00 -	8.63	(734,943)
Cancelled	(559,602)	5.50 -	12.00	(4,083,997)
Outstanding, December 31, 1989	1,887,201	$ 1.00 -	$ 14.00	$ 12,161,328

Note 11. Segment Information

The Company operates in one industry segment—the design, manufacture, sale and servicing of consumer electronic products.

The Company's foreign operations consist of manufacturing facilities in the Far East and distribution facilities in Europe, Australia, and North America. Transfers between geographic areas are accounted for at amounts generally above cost. Corporate assets are cash and equivalents. The following table presents a summary of operations by geographic region (in thousands):

	1989	*1988*	*1987*
Revenues from unaffiliated customers:			
North America	$ 76,773	$ 133,189	$ 136,458
Export sales from North America	16,704	14,883	19,768
Europe	307,381	291,645	203,772
Other	22,748	12,484	2,610
Total	$ 423,606	$ 452,201	$ 362,608
Transfers from geographic areas (eliminated in consolidation):			
North America	$ 432,915	$ 363,824	$ 288,241
Europe	42,214	15,942	10,155
Other	295,527	310,073	233,697
Total	$ 770,656	$ 689,839	$ 532,093
Operating income (loss):			
North America	$ (1,618)	$ 35,188	$ 54,896
Europe	(2,194)	13,974	8,330
Other	7,490	10,430	8,790
Total	$ 3,678	$ 59,592	$ 72,016
Identifiable assets at December 31:			
North America	$ 22,881	$ 48,326	$ 43,478
Europe	142,681	125,013	108,577
Other	110,178	73,129	82,743
Discontinued operations	—	—	57,010
Corporate assets	54,912	91,890	94,094
Total	$ 330,652	$ 338,358	$ 385,902

Note 12. Related Party Transactions

In 1986, the Company issued promissory notes to a supplier for $3,816,480. The notes were due within one year and did not bear interest. The Company's principal shareholder purchased these notes from the supplier at a 12% discount. These notes were paid in full in 1986 and 1987.

In 1987, the Company purchased approximately 284,000 shares of Federated common stock at various prices (approximating $5 per share representing actual cost plus broker margin interest cost, a total of $1,455,000) directly from Atari Corporation's principal shareholder.

Note 13. Contingent Liabilities

Certain claims and suits arising in the ordinary course of business have been filed or are pending against the Company. In the opinion of management, all such matters have been adequately provided for, are without merit, or are such that if disposed of unfavorably would not have a material adverse effect on the Company's consolidated financial position.

The Company is both a plaintiff and defendant in several lawsuits arising out of its acquisition of Federated. The Company is presently prosecuting or defending these actions and intends to continue to do so. The Company believes these actions will not have a material adverse effect on the Company's consolidated financial position.

Note 14. Quarterly Financial Data (Unaudited)

Summarized quarterly financial data for 1989 and 1988 are as follows (in thousands except per share data):

Year Ended December 31, 1989	*First Quarter*	*Second Quarter*	*Third Quarter*	*Fourth Quarter*
Net sales	$88,776	$ 82,740	$81,444	$170,646
Gross margin	30,376	28,104	17,678	38,029
Income (loss) from continuing operations	3,288	327	(5,395)	5,797
Net income (loss)	3,288	327	(5,395)	5,797*
Earnings per common and common equivalent share:				
Primary:				
Income (loss) from continuing operations**	.06	.01	(.09)	.10
Net income (loss)**	.06	.01	(.09)	.10
Fully diluted:				
Income (loss) from continuing operations**	.06	.01	(.09)	.10
Net income (loss)**	.06	.01	(.09)	.10
Highest stockprice as reported on the consolidated transaction system:	7	9⅛	12¾	12***
Lowest stockprice as reported on the consolidated transaction system:	4¾	5⅞	7½	8⅜***

Year Ended December 31, 1988	*First Quarter*	*Second Quarter*	*Third Quarter*	*Fourth Quarter*
Net sales	$98,321	$102,518	$98,798	$152,564
Gross margin	39,606	41,816	37,089	53,242
Income from continuing operations	15,074	7,866	7,111	9,352
Net income	5,674	5,571	900	(96,963)
Earnings per common and common equivalent share:				
Primary:				
Income from continuing operations	.26	.14	.12	.16
Net income (loss)	.10	.10	.02	(1.67)
Fully diluted:				
Income from continuing operations	.25	.14	.12	.16
Net income (loss)	.10	.10	.02	(1.54)
Highest stockprice as reported on the consolidated transaction system:	9⅛	8⅝	9	7⅝***
Lowest stockprice as reported on the consolidated transaction system:	5⅞	6¼	6¼	4⅞***

**See Note 9*

***The sum of net income per share for the four quarters does not equal the annual amount as reported on the consolidated statements of operations due to rounding.*

****The Company's common stock is traded publicly on the American Stock Exchange and the Pacific Stock Exchange under the symbol ATC. At March 30, 1990 there were 1,939 shareholders of record.*

Opinion of Independent Public Accountants

To the Shareholders and Board of Directors of Atari Corporation:

We have audited the accompanying consolidated balance sheets of Atari Corporation and its subsidiaries as of December 31, 1989 and 1988, and the related consolidated statements of operations, shareholders' equity, and cash flows for each of the three years in the period ended December 31, 1989. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the consolidated financial position of the companies at December 31, 1989 and 1988, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 1989 in conformity with generally accepted accounting principles.

Deloitte & Touche

DELOITTE & TOUCHE

San Jose, California, March 8, 1990

Introduction

The Company commenced operations in May 1984, and in July 1984, it acquired certain computer and video game system assets from, and assumed certain liabilities of WCI. See Note 2 to the Consolidated Financial Statements. The Company's net sales from its inception through June 1985 consisted primarily of the liquidation of the inventories that were acquired from WCI. These inventories are referred to as the "purchased products" in the Company's financial statements. The Company commenced sales of its re-engineered and redesigned products in the last quarter of 1984, and began introducing new products in the second quarter of 1985. These products, including video game systems, computers and related peripherals, are referred to as the "new and redesigned products" in the Company's financial statements.

During the fourth quarter of 1987, the Company acquired the Federated Group, Inc., a chain of consumer electronics retail stores. In March 1989, as a result of Federated's losses and cash flow requirements, the Board of Directors approved the Company's decision to discontinue its operation of Federated. Subsequent to year end, in January 1990, the Company sold 22 of the southern California leasehold interests held by its discontinued Federated unit, to Silo California Inc. The Company expects substantially to complete the disposition of Federated by the end of 1990, and no additional losses are anticipated. See Notes 1 and 3 to the Consolidated Financial Statements.

Results of Operations for the Year Ended December 31, 1989

Income from continuing operations was $4.0 million in 1989 compared to $39.4 million in 1988, due to a combination of lower sales and reduced gross margins.

Net sales for the year ended December 31, 1989 were $423.6 million compared to $452.2 million the previous year, a reduction of 6%. International sales accounted for 82% of the total net sales and were therefore subject to the influence of fluctuations in foreign exchange rates compared to the US dollar. The change in exchange rates alone was responsible for a 7% reduction in sales in 1989 compared to 1988. Sales of ST and PC products increased by 9% to $322.0 million, or 76%, of total net sales in 1989, from $296.5 million, or 66%, of total net sales in 1988. Conversely, sales of games products such as the 2600 and 7800 game systems and the range of older XE 8 bit computers decreased by 35% to $101.6 million, or 24%, of total net sales for the year ended December 31, 1989, from $155.5 million, or 34%, of total net sales in 1988. Two significant new products, the Portfolio hand held computer and the Lynx color portable game system, which were launched late in 1989, contributed sales of $25.5 million.

Gross margin declined from $171.8 million in 1988 to $114.2 million in the year ended December 31, 1989. This was partly due to a 6% reduction in sales volume, and partly due to a reduction in gross margin from 38% to 27% resulting from the adverse change in exchange rates, a reduction in average selling prices, and a change in product mix between the higher margin game software products and lower margin computer hardware sales. Availability and price of DRAM returned to stable and cheaper levels during 1989 but the high prices paid for DRAM in inventory continued to impact margins for the year as a whole.

Research and development expenses increased from $21.4 million, or 5% of net sales, in the year ended December 31, 1988 to $24.6 million, or 6% of sales, in the corresponding period of 1989. The increased expenditure relates mainly to the development of the new Portfolio, Lynx, STACY and STE (an enhanced ST) product lines. There was also considerable continuing investment in game software development for the existing range of games products. During 1989, 24 new games were completed.

Marketing and distribution costs declined 8%, from $71.9 million in the year ended December 31, 1988, to $66.4 million in the corresponding period of 1989. Worldwide marketing and advertising levels were cut back during the year in anticipation of increasing pressure on margins. Also, although both the new Portfolio and Lynx products were launched in 1989, constraints in availability and their release so late in the year resulted in a limited launch campaign.

General and administrative expenses increased by 3% from $18.9 million in the year ended December 31, 1988 to $19.5 million in the corresponding period of 1989 as a result of increased scale of operations and continuing inflationary pressure on costs in many overseas markets.

Other income for the year ended December 31, 1989 amounted to $1.0 million compared to other expense of $1.7 million for the preceding year, mainly due to fluctuations in the impact of foreign exchange rates.

Interest income declined from $5.4 million to $4.1 million and interest expense increased from $4.8 million to $6.3 million as a result of higher interest rates, lower average cash balances, and higher short-term borrowings in 1989 compared to 1988.

In the fourth quarter of 1989, the Company decreased its effective annual tax rate from a credit of 34% to a credit of 63%, due primarily to the utilization of foreign tax loss carryforwards. This resulted in an effective tax rate of a credit of 12% for the fourth quarter of 1989. The effective rate of income tax for 1989 was a credit of 63% compared to a charge of 33% for the year ended December 31, 1988. This was primarily due to the tax benefit of foreign loss carryforwards.

Results of Operations for the Year Ended December 31, 1988

The loss of $84.8 million in the year ended December 31, 1988, is attributable to the discontinuation of Federated operations as of December 1988. The Company wrote off its investment in Federated and provided for additional anticipated financial obligations and losses arising from the disposition of Federated, a total of $64.8 million, before income tax benefits of $7.8 million. Federated reported a net loss of $67.2 million in 1988 compared to $5.3 million in 1987. Included in the net loss for 1988 was a fourth quarter charge of $39.9 million related to receivables, inventories, investments in leveraged leases, goodwill, accounts payable and accrued liabilities.

Sales increased by 25% from $362.6 million in 1987 to $452.2 million in 1988, principally due to increased sales of ST computers and the new range of PC compatible products. Sales of ST and PC products increased by 36%, from $218.1 million in 1987 to $296.5 million in 1988. In 1988 65% of total sales were in Europe compared to 56% in 1987: the ability to develop the North American market was constrained during the year by the restricted availability of Dynamic Random Access Memory (DRAM).

Gross margin declined from 43% in 1987 to 38% in 1988, due partly to the impact of deteriorating exchange rates on the dollar value of overseas sales revenue, partly to a change in product mix, and partly to the increased cost of DRAM. Throughout 1988 there was a worldwide shortage of DRAM and the Company was forced to buy at market rates whenever DRAM was available. Because it was anticipated that this shortage was only a short term phenomenon, it was decided to hold selling prices fixed, absorbing the increased cost, in order to maintain the sales momentum that had been built up, particularly in Europe.

Research and development expense increased $3.3 million or 18% in 1988 compared to 1987. Substantially all of the funds were expended on new products, including the Mega 1, further developments of the PC family, a new range of 16 and 32 bit computers, and a new 16 bit Game System. There was also a continuing increase in the cost associated with the development of a range of new software for the XE Game System, 2600 VCS and 7800 ProSystem markets.

Marketing and distribution expenses increased $18.1 million or 34% in 1988 compared to 1987, representing 16% of sales compared to 15% the previous year. The reason for this increase relates principally to launching of the new range of PC products in 1988, but increased amounts were spent on advertising the XE and 2600 and 7800 game systems in the face of strong competition from another international competitor, especially in the North American market. Additionally, the new sales operations established during 1987 in Australia, Denmark, Mexico, Norway, Spain and Sweden continued to grow in size and level of sales through 1988.

General and administrative expenses were $18.9 million in 1988 compared to $13.7 million in 1987, an increase of $5.2 million or 38%. The absolute increase is mainly attributable to higher costs from the addition of new sales subsidiaries at a full operating level, and for a full year, in 1988 compared to 1987. As a percent of total sales, they remained constant at 4% of sales in both years.

In 1988 other expense of $1.7 million included exchange losses of $4.8 million whereas in 1897 other income of $7.3 million included exchange gains of $3.8 million. Interest income decreased by $1.8 million to $5.4 million in 1988. The decrease is attributable to lower cash deposits resulting mainly from the cash expended on Federated during 1988.

Interest expense in 1988 increased by $1.6 million to $4.8 million, principally as a result of recording interest on the $75 million debenture for a full year in 1988 compared to only eight months in 1987.

The provision for income taxes in 1988 was $19.1 million, an effective rate of 33%, compared to $33.8 million or 41% in 1987. In the fourth quarter of 1988, the Company increased its effective annual tax rate from 29% to 33% due primarily to foreign tax assessments resulting from a tax audit of the WCI transaction. Effective January 1, 1988, the Company adopted Statement of Financial Accounting Standard No. 96 (SFAS 96), "Accounting for Income Taxes." The effects of adopting SFAS 96 were not material in 1988.

International Sales

Net sales outside North America for fiscal 1987, 1988 and 1989 were $226.2 million, $319.0 million, and $346.8 million (62%, 71%, and 82% of net sales), respectively. For additional operations information by geographic region, see Note 11 of the Notes to Consolidated Financial Statements. The Company's international operations were subject to the risks of fluctuation of the values of the U.S. dollar and foreign currencies. For information concerning the effect of foreign currency transactions on the Company's results of operations through December 31, 1989, see Note 1 of the Notes to Consolidated Financial Statements.

Liquidity and Capital Resources

Working capital decreased by $4.4 million, from $144.0 million in 1988 to $139.6 million in 1989. Inventory increased $12.0 million due to a buildup of raw materials purchased for Lynx and Portfolio production which started in the last quarter of 1989. During the year the Company borrowed $2.4 million in the form of a mortgage secured on purchased land and buildings in Paris, France,

and is in the process of negotiating finance facilities with which to build new office and warehouse premises near Frankfurt, Germany.

Cash and cash equivalents declined from $91.9 million to $54.9 million while short-term borrowings increased from $18.5 million to $35.4 million. The disposition of discontinued operations consumed $35.5 million of this cash, purchase of property and other assets, including technology purchases, a further $9.4 million.

The seasonal nature of the Company's operations requires greater availability of finance facilities in the second and third quarters of the year in order to fund peak working capital requirements. The Company believes that existing cash balances together with further facilities of approximately $16.2 million of multicurrency bank credit agreements, and funds anticipated to be generated from operations, will be sufficient to meet its cash requirements through 1990, and that it will not be necessary to raise additional funds to meet expenditures required to operate the Company's business during that period. However, the Company intends to seek additional bank or institutional credit lines for use in connection with future working capital and capital asset development needs. No negotiations have commenced with prospective lenders, and no assurance can be given that any such credit lines can be established on terms acceptable to the Company. No specific uses of any such future borrowings have been identified. The Company is proceeding with the disposition of its Federated business and does not anticipate that this process will have any material adverse impact on its liquidity and working capital.

Selected Financial Data

December 31, (in thousands, except per share data)	*1989*	*1988*	*1987*	*1986*	*1985*
STATEMENT OF OPERATIONS DATA:					
Net Sales:					
New and redesigned products	$ 423,606	$ 452,201	$ 358,003	$ 215,002	$ 47,817
Purchased product	—	—	4,605	43,129	94,170
Total	426,606	452,201	362,608	258,131	141,987
Operating income (loss)	3,678	59,592	72,016	48,215	(25,819)
Income (loss) from continuing operations	4,017	39,403	49,409	25,050	(14,314)
Income (loss) before extraordinary credit	4,017	(84,818)	44,152	25,050	(14,314)
Net income (loss)	$ 4,017	$ (84,818)	$ 57,429	$ 44,516	$ (14,314)
PER SHARE DATA:					
Primary:					
Income (loss) from continuing operations	$ .07	$ .68	$ .85	$ .53	$ (.31)
Income (loss) before extraordinary credit	.07	(1.46)	.76	.53	(.31)
Net income (loss)	.07	(1.46)	.99	.95	(.31)
Fully Diluted:					
Income (loss) from continuing operations	$ .07	$ .67	$ .83	$ .53	$ (.31)
Income (loss) before extraordinary credit	.07	(1.31)	.74	.53	(.31)
Net income (loss)	.07	(1.31)	.96	.95	(.31)
BALANCE SHEET DATA:					
Working capital	$ 139,562	$ 143,955	$ 188,499	$ 96,484	$ 11,749
Total assets	330,652	338,358	385,902	184,176	139,044
Long-term obligations (including current portion)	77,402	75,000	75,000	2,003	57,082
Shareholders' equity (deficiency)	$ 85,999	$ 83,231	$ 167,655	$ 105,422	$ (19,477)

See Note 3 of Notes to the Consolidated Financial Statements for information concerning discontinued operations.
See also Note 1 of Notes to the Consolidated Financial Statements.

Directors

JACK TRAMIEL
Chairman of the Board

SAMUEL W. L. CHIN
Vice President

GREGORY A. PRATT
Vice President—Finance, Chief Financial Officer

MICHAEL ROSENBERG
Chairman & Chief Executive Officer—Ross & Roberts, Inc.

LEONARD I. SCHREIBER
Partner—Schreiber & McBride

SAM TRAMIEL
President, Chief Executive Officer

Officers

JACK TRAMIEL
Chairman of the Board

SAM TRAMIEL
President, Chief Executive Officer

SAMUEL W. L. CHIN
Vice President

STEVEN M. KAWALICK
Vice President—Treasurer

AUGUST J. LIGUORI
Vice President

RICHARD MILLER
Vice President—Technology

GREGORY A. PRATT
Vice President—Finance, Chief Financial Officer

ELTON SOUTHARD
Vice President—Semiconductor Operations

TARO TOKAI
Vice President

GARRY TRAMIEL
Vice President—Administration and Secretary

LEONARD TRAMIEL
Vice President—Software Development

SIMON P. WESTBROOK
Vice President—Controller

Corporate Information

TRANSFER AGENT
Registrar and Transfer Company
10 Commerce Dr.
Cranford, NJ 07016

AUDITORS
Deloitte & Touche
Suite 1200
One Almaden Blvd.
San Jose, CA 95113

GENERAL COUNSEL
Schreiber and McBride
30 Park Avenue
New York, NY 10016

ANNUAL MEETING
The Annual Meeting of Shareholders will be held on Tuesday, May 15, 1990 at 2:00 p.m. at the Atari corporate meeting room 390 Caribbean Drive Sunnyvale, CA 94089.

FORM 10-K ANNUAL REPORT
A copy of the Company's Annual Report on Form 10-K (exclusive of exhibits) as filed with the Securities and Exchange Commission is available upon request directly from the Company.

Offices

Atari Computer Corporation
1196 Borregas Avenue
Sunnyvale, CA 94086
Tel: 408-745-2000
Tlx: 172508 ATARIHQSUVL
713719623 Domestic
3719623 International
Fax: 408-745-4306
408-745-5179

Atari Software
330 N. Eisenhower Lane
Lombard, IL 60148
Tel: 708-629-6500
Fax: 708-629-6699

Atari Dallas Corp.
2161 Hutton Drive, Suite 200
Carrollton, TX 75006
Tel: 214-484-7812
Fax: 214-484-8654

Australia
Atari Computers Pty. Ltd.
376 Lane Cove Road
North Ryde N.S.W. 2113
Tel: 61-2-805-0344
Fax: 61-2-887-2231

Austria
Atari Computer GmbH
Zweigniederslassung
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A1040 Vienna
Tel: 43-222-565155
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Belgium
Atari (Benelux) B.V.
Boomsesteenweg 28,
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Tel: 32-3-844-3366
Fax: 32-3-844-0307

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Atari (Canada) Corp.
90 Gough Road, Markham
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Tel: 416-479-1266
Tlx: 389-696-6728
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Atari Corp. Sverige AB
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Fax: 49-6142-209180
&
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Tel: 0621-61471

Hong Kong
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Fax: 852-3-418-655

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Fax: 813-450-7119

Mexico
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Viveros de la Loma
Tlalnepantla
Estado de Mexico
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Taipei
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Tlx: 785-31125/31138
Fax: 886-2-622-3660

ATARI
CORPORATION

ATARI CORPORATION

1196 Borregas Avenue
Sunnyvale, California 94086

NOTICE OF ANNUAL MEETING OF SHAREHOLDERS

TO BE HELD ON MAY 15, 1990

To the Shareholders of
ATARI CORPORATION

The Annual Meeting of Shareholders of Atari Corporation ("the Company") will be held on Tuesday, May 15, 1990 at 2:00 p.m. (PDT) at the Company's Meeting Room, 390 Caribbean Drive, Sunnyvale, CA 94089, for the following purposes:

1. To elect a Board of Directors to serve for the ensuing year and until their successors are elected.

2. To ratify the appointment of Deloitte & Touche as independent auditors for the Company for the year ending December 31, 1990.

3. To transact such other business as may properly come before the meeting or any adjournment thereof.

The foregoing items of business are more fully described in the Proxy Statement accompanying this Notice. Only shareholders of record on the Company's books at the close of business on March 30, 1990, will be entitled to vote at the meeting.

All shareholders are cordially invited to attend the meeting. Shareholders are requested to complete, date, sign and return the enclosed proxy card as promptly as possible in the postage pre-paid envelope enclosed for that purpose. The giving of such proxy will not affect your right to vote in person should you decide to attend the meeting.

By Order of the Board of Directors

Garry Tramiel

Garry Tramiel
Secretary

Dated: April 24, 1990

ATARI CORPORATION

1196 Borregas Avenue
Sunnyvale, California 94086
(408) 745-2000

PROXY STATEMENT

Annual Meeting of Shareholders
May 15, 1990

SOLICITATION OF PROXIES

This Proxy Statement is furnished in connection with the solicitation of proxies by the Board of Directors of Atari Corporation, a Nevada corporation (the "Company"), for use for the purposes set forth herein and in the accompanying Notice at the Annual Meeting of Shareholders to be held May 15, 1990, at 2:00 p.m. at the Company's Meeting Room, 390 Caribbean Drive, Sunnyvale, California 94089, and all adjournments and postponements thereof (the "Meeting").

This Proxy Statement and the accompanying form of proxy were first mailed to shareholders entitled to notice and vote at the Meeting on or about April 24, 1990.

The cost of preparing, assembling and mailing the Notice of Annual Meeting of Shareholders, Proxy Statement and form of proxy and the solicitation of proxies will be paid by the Company. In addition to this solicitation, proxies may be solicited in person or by telephone or telegraph by Directors, officers, employees or agents of the Company who will not receive any additional compensation for such solicitation. The Company will furnish proxy materials to brokers, fiduciaries or custodians holding shares in their names that are beneficially owned by others, to permit them to forward such materials to such beneficial owners. The Company will reimburse brokers or other persons holding stock in their names or the names of their nominees for the expenses of forwarding soliciting material to their principals.

VOTING

The close of business on March 30, 1990 has been fixed as the record date for the determination of shareholders entitled to notice of and to vote at the meeting. On that date there were 57,713,180 shares of the Company's Common Stock outstanding. Each shareholder of record on the record date is entitled to one vote for each share of Common Stock held by such shareholder on any matter that may be presented for consideration and action by the shareholders at the Meeting. In the election of Directors, those Directors and nominees receiving the most votes cast (provided a quorum is present) will be elected. Any other action shall be authorized by a majority of the votes cast at the Meeting, provided a quorum is present. Shareholders are not permitted to cumulate their votes in the election of Directors.

Proxies duly executed and received by the Company prior to the Meeting will be voted **FOR** the proposals as stated unless the shareholder otherwise directs in the shareholder's proxy. Where a shareholder has appropriately directed how the proxy is to be voted, it will be voted according to the shareholder's direction. Any shareholder has the power to revoke the proxy at any time before it is voted at the meeting by submitting written notice of revocation to the Secretary of the Company, or by filing a duly executed proxy bearing a later date. A proxy will not be voted if the shareholder who executed it is present at the meeting and elects to vote the shares represented thereby in person.

CERTAIN OWNERSHIP OF COMMON STOCK

The following table sets forth information, as of March 30, 1990, with respect to beneficial ownership of Common Stock (a) by persons known by the Company to be the beneficial owners of more than 5% of the outstanding Common Stock, (b) by each director or nominee, and (c) by all directors and officers of the Company as a group.

Name of Beneficial Owner (1)	Amount and Nature of Beneficial Ownership	Percent of Outstanding Common Stock (1)
Jack Tramiel	25,300,156 (2 & 3)	43.8%
Warner Communications, Inc.	14,200,000 (2)	24.6%
Sam Tramiel	1,056,689 (4)	1.8%
Leonard I. Schreiber	219,500 (5)	—
Samuel W. L. Chin	110,600 (6)	—
Gregory A. Pratt	62,500 (7)	—
Michael Rosenberg	50,000 (8)	—
All directors and executive officers as a group (16 persons)	29,577,635	51.2%

(1) Percentage information is omitted for those individuals whose shares beneficially represent less than 1% of the outstanding shares of the Company's Common Stock.

(2) The address of Mr. Jack Tramiel is 1196 Borregas Avenue, Sunnyvale, California 94086. The address of Warner Communications, Inc. is 75 Rockefeller Plaza, New York, New York 10019.

(3) The number of shares indicated as beneficially owned by Mr. Jack Tramiel excludes an aggregate of 3,527,879 shares owned by his sons and an aggregate of 233,088 shares held by 3 other family members, as to which Mr. Jack Tramiel disclaims beneficial ownership.

(4) Does not include 233,088 shares held in trust for Mr. Sam Tramiel's three minor children.

(5) Does not include 14,000 shares each owned by Ellen W. McBride and Laurie L. Baker, daughters of Mr. Schreiber, and 4,000 shares owned by Barbara E. Schreiber, Mr. Schreiber's wife, as to which Mr. Schreiber disclaims beneficial ownership.

(6) Does not incude 8,000 shares held in trust for Mr. Chin's two children.

(7) Does not incude 10,000 shares held in trust for Mr. Pratt's two children.

(8) In addition, Mr. Rosenberg owns $100,000 par value of Atari 5 1/4% Convertible Subordinated Debentures.

ELECTION OF DIRECTORS

The Company's directors are to be elected at each annual meeting of shareholders. At this Meeting, six directors will be elected to serve until the next annual meeting of shareholders and until their successors are elected and qualified. The nominees for election as directors at this Meeting set forth in the table below. All are incumbent directors who have served as such during the last fiscal year. Each of the nominees has consented to serve as a director if elected.

In the event that any of the nominees for directors should become unable to serve if elected, it is intended that shares represented by proxies which are executed and returned will be voted for such substitute nominee(s) as may be recommended by the Company's existing Board of Directors. To the best of the Company's knowledge, all nominees are and will be available to serve.

Nominee	Age	Position(s) with the Company
Jack Tramiel	61	Chairman of the Board
Sam Tramiel	40	Director, President and Chief Executive Officer
Samuel W. L. Chin	39	Director, Vice President–Manufacturing Operation
Leonard I. Schreiber	75	Director
Gregory A. Pratt	41	Director, Vice President–Finance, Chief Financial Officer
Michael Rosenberg	62	Director

Jack Tramiel founded the Company in May 1984 and has served as its Chairman and, until May 1988, Chief Executive Officer. Until January 1984, he was a Director and President of Commodore Business Machines, Ltd., which he founded in 1958. Mr. Tramiel is the father of Sam, Garry and Leonard Tramiel.

Sam Tramiel has been President, Chief Operating Officer and a Director of the Company since June 1984 and became Chief Executive Officer in 1988.

Samuel W. L. Chin joined the Company as its Vice President, Chief Financial Officer and Treasurer and was elected as a director of the Company in June 1984. He served as General Manager of Atari Taiwan Manufacturing Company from 1985 to 1987. He is a Certified Public Accountant.

Leonard I. Schreiber has been a Director of the Company since its formation in 1984 and served as a Vice President and Secretary of the Company from its formation through 1986. He is a partner of Schreiber & McBride, which serves as General Counsel to the Company. He has been Mr. Tramiel's personal counsel, and until May 1984 had been counsel to Commodore International, Ltd., for over twenty years.

Gregory A. Pratt joined the Company in June 1984 as General Manager. In February 1985, Mr. Pratt became the Company's Vice President–Finance and Chief Financial Officer and was elected to the Board of Directors in May 1987. He is a Certified Public Accountant.

Michael Rosenberg was elected to the Company's Board of Directors in May 1987. Mr. Rosenberg has been Chairman and Chief Executive Officer of Ross & Roberts, Inc., since he acquired that company from the Bemis Company, Inc. in September 1987. Prior to this he was employed by Ross & Roberts, Inc. He is a Certified Public Accountant.

Board Meetings and Committees

The Company's Board of Directors met 2 times during 1989. Each director attended 100% in aggregate of the meetings of the Board of Directors and of the Committees on which such director served during the year. The Company seeks potential nominees for Board membership in various ways and will consider suggestions submitted by stockholders. Any such stockholder suggestion should be submitted, in writing, to the Secretary of the Company at the above address.

On May 16, 1989 the Board appointed the following Committees on which the following directors were appointed to serve:

Executive Committee: Jack Tramiel, Sam Tramiel and Gregory A. Pratt—The Committe met 11 times during the year.

Audit Committee: Leonard I. Schreiber and Michael Rosenberg—The Committee met once during the year.

Compensation and Stock Option Committee: Jack Tramiel, Leonard I. Schreiber and Michael Rosenberg—The Committee met once during the year.

Management recommends voting "FOR" the election of Messrs. J. Tramiel, S. Tramiel, Chin, Schreiber, Pratt and Rosenberg. Unless otherwise directed by a shareholder, proxies will be voted "FOR" the election of such nominees.

EXECUTIVE OFFICERS OF THE COMPANY

The following table sets forth those executive officers of the Company not set forth above as Directors:

Name	Age	Position(s) with the Company
Steven M. Kawalick	38	Vice President-Treasurer and Assistant Secretary, Atari Corporation, since May 1987; Director of Taxes, Atari Corporation, July 1984 to May 1987; employed by Arthur Andersen prior to July 1984.
August J. Liguori	38	Vice President-Atari Corporation since October 1989; Vice President and General Manager, Atari U.S. since November 1986, Vice President of Administration, Atari U.S. since April 1986; Vice President of Finance-Knickerbocker Toy Co., subsidiary of Warner Communications Inc. since May 1982.
Ellen McBride	49	Assistant Secretary since May 16, 1989; currently a member of the law firm of Schreiber & McBride where she has been a partner since 1985.
Richard Miller (appointed Oct. 2, 1989)	27	Vice President-Technology, Atari Corporation, since October 1989; Technical Manager, Atari U.K. Corp. Ltd. since February 1989; Managing Director of Perihelion Ltd. from April 1987 to February 1989; prior to April 1987, independent consultant.
Elton Southard	62	Vice President-Semiconductor Operations, Atari Corporation, since October 1987; Sr. Vice President-Engineering, Robinton Products, Inc., November 1986 to October 1987; independent consultant, March 1985 to November 1986; Group Vice President-Commodore Semiconductor Group prior to March 1985.
Taro Tokai	44	Vice President, Atari Corporation since July 1984; Vice President and General Manager, Atari Japan Corp., since July 1984.
Garry Tramiel	30	Secretary, Atari Corporation since September 1986; Assistant Treasurer and Vice President-Administration, Atari Corporation since July 1984, Assistant Secretary, Atari Corporation from July 1984 to August 1986.
Leonard Tramiel	35	Vice President-Software Development, Atari Corporation, since July 1984.
Simon P. Westbrook	41	Vice President-Corporate Controller, Atari Corporation, since April 1990; Financial Controller Atari Corporation, January 1987 to March 1990; UK and European Controller between March 1984 and January 1987. He is a Chartered Accountant and was employed by Arthur Andersen & Co. between 1970 and 1975.

EXECUTIVE COMPENSATION AND OTHER INFORMATION

Executive Compensation

The following table sets forth the cash compensation paid by the Company for services during the 1989 fiscal year to the five most highly compensated executive officers and all executive officers as a group:

Name of Individual or Number in Group	Capacities in which served	Cash Compensation (1)
Taro Tokai	Vice President	$ 208,735
Sam Tramiel	President and Chief Operating Officer	$ 200,198
Jack Tramiel	Chairman	$ 179,850
Elton Southard	Vice President–Semiconductor Operations	$ 151,404
Gregory A. Pratt	Vice President–Finance, Chief Financial Officer	$ 150,204
All executive officers as a group (14 persons including those named above) (2)		$1,656,056

(1) Compensation includes salaries, bonuses and employer contribution to life insurance policies. No executive officer received other compensation in excess of $25,000 or 10% of each such officer's cash compensation, nor did all executive officers as a group receive additional compensation in excess of $25,000 times the number of such officers, or 10% of such officers' aggregate cash compensation. The Company has no pension or retirement plans.

(2) Includes $100,651 in salary and severence payments to a former employee who served as an executive officer during a portion of the past fiscal year.

Bonus Plan

The Company has a bonus plan whereby a bonus pool equal to 10% of the yearly increase in after tax profits is made available for distribution on a discretionary basis. The Board of Directors feels that such a plan is necessary to attract and keep qualified employees. In 1989 after tax profits, for purposes of this computation, did not increase and accordingly there was no bonus pool, or bonus payments in the year. The Company paid director's fees of $500 per meeting during the year to each of its outside directors, Messrs. Schreiber and Rosenberg.

Stock Options

In 1986, the Company adopted a stock option plan and restricted stock plan as amended at the Annual Meeting of Shareholders held on May 16, 1989. At December 31, 1989, options to purchase 1,887,201 shares of Common Stock were outstanding under the Option Plan at an average exercise price $6.44. The following table sets forth information

as to options to purchase Common stock granted to, or exercised by, each of the five most highly compensated executive officers, all executive officers as a group, and all employees (including executive officers) for the last three fiscal years. Directors who are not employees are not eligible to be granted options under the Plan.

Name or Number of Individuals in Group	Options Granted Net of Repurchases	Weighted Exercise Price	Net Value of Shares or Cash Realised
Taro Tokai	25,000	$ 6.00	—
Sam Tramiel	100,000	$ 6.00	
Jack Tramiel	-None-		
Elton Southard	100,000	$ 6.00	—
Gregory A. Pratt	250,000	$ 6.09	—
All executive officers as a group (14 persons including those named above) (1)	898,000	$ 6.09	$ 180,750
All employees including executive officers as a group (1)	1,890,570	$ 6.92	$1,302,387

(1) Includes 25,000 options at $6.75 which were granted to, and exercised during the year by, a former employee who served as an executive officer during a portion of the past fiscal year.

CERTAIN TRANSACTIONS

Under a January 1986 agreement with a supplier, the Company issued $3,816,480 aggregate principal amount promissory notes to the supplier. The notes did not bear interest and were payable monthly, through July 1987. Jack Tramiel purchased these notes from the supplier at a discount. During 1987, the Company paid the remaining balance under the notes to Mr. Tramiel; approximately $433,000.

In 1987, the Company purchased directly from Jack Tramiel approximately 284,000 shares of The Federated Group, Inc. (Federated) common stock at various prices (approximating $5.00 per share representing actual cost plus broker margin interest cost for a total of $1,455,000).

In September 1989, Mr. Rosenberg purchased $2,280,000 face value Federated 7 1/2% convertible subordinated debentures. Prior to the purchase Mr. Rosenberg offered, and the Company declined, the opportunity to purchase these debentures. Mr. Rosenberg offered the Company a further opportunity to purchase the debentures at cost, at any time, and in March 1990, the Company exercised its option to purchase the debentures at cost in the amount of $742,762 inclusive of $74,262 of accrued interest.

The law firm of Schreiber & McBride, of which Leonard I. Schreiber, a director of the Company, and his daughter, Ellen McBride, are partners, provides legal services to the Company. During 1989, the Company paid to Schreiber & McBride $78,767 in fees.

Loans in the principle amounts of $125,000 and $145,000 were outstanding from the Company to Messrs. Pratt and Miller respectively for the purpose of home purchase. The loans carry interest of 10% per annum and 9.6% compounded quarterly, respectively, and are repayable on demand. Both loans were outstanding at the end of the year, and these were also the maximum amounts outstanding at any time during the year.

SHAREHOLDER PROPOSALS

Shareholders intending to offer proposals for consideration at the Company's 1991 Annual Meeting of Shareholders must deliver the proposal to the Company by December 26, 1990 to be included in its proxy statement and form of proxy relating to that meeting. Such proposals must comply with applicable corporation laws and with regulations of the Securities and Exchange Commission with respect to matters which may properly be submitted for action by the shareholders, and should be addressed to the Secretary of the Company at 1196 Borregas Avenue, Sunnyvale, CA 94089.

RATIFICATION OF APPOINTMENT OF AUDITORS

Messrs. Deloitte & Touche have served as the Company's independent auditors since 1984. The Board of Directors has again selected such firm to audit the financial statements of the Company for the year ending December 31, 1990 and submits this selection for shareholder approval. If the shareholders reject this selection, the Board will consider other firms of independent auditors. A representative of Deloitte & Touche will be present at the Annual Meeting and may make a statement and respond to appropriate shareholder questions.

Management recommends voting "FOR" the election of Deloitte & Touche as auditors. Unless otherwise directed by a shareholder, proxies will be voted "FOR" the election of Deloitte & Touche as independent auditors.

ANNUAL REPORTS

The Company's Annual Report for the fiscal year ended December 31, 1989, is being mailed to shareholders with the proxy materials; however, such report is not incorporated in this Proxy Statement and shall not be deemed to be a part of this Proxy solicitation material. The Company files an Annual Report on Form 10-K with the Securities and Exchange Commission. SHAREHOLDERS MAY OBTAIN A COPY OF THE FORM 10-K ANNUAL REPORT WITHOUT CHARGE, BY WRITING TO INVESTOR RELATIONS AT THE ADDRESS LISTED ABOVE.

OTHER BUSINESS AND DIRECTOR NOMINATIONS

At the time of the preparation of this Proxy Statement, the Company's Board of Directors had not been informed of any other matters which would be presented for action at the Annual Meeting. If any other matters are properly presented, the persons named in the accompanying form of Proxy will vote or refrain from voting in accordance with their best judgment.

By Order of the Board of Directors

Garry Tramiel

Garry Tramiel
Secretary

These documents were created on an Atari desktop publishing system (Atari Desk Set II™ software using the MEGA4™ computer, MEGAFILE 44™ removable cartridge hard disk drive, and SLM804™ laser printer). These documents were typeset on an AGFA Compugraphic MCS™ 8400 typesetter using G.O. Graphics' Typesetter Driver Option™ card interface.